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No. 91-521

In The

Supreme Court of the United States

October Term 1991

BANCO POPULAR DE PUERTO RICO,

Petitioner,

v.

MUNICIPALITY OF MAYAGUEZ,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of Puerto Rico

RESPONDENT'S BRIEF IN OPPOSITION

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January 8, 1992

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent Municipality of Mayaguez respectfully requests that this Court deny the petition for a writ of certiorari seeking review of two judgments of the Supreme Court of the Commonwealth of Puerto Rico. The first judgement was issued on March 14, 1988 and is unofficially reported as *Banco Popular de Puerto Rico v. Municipality of Mayaguez*, P.R. Bar Ass'n. Adv. Sh. 1988-26; 88 JTS 29; the other one, on rehearing was issued on June 29, 1990, bears the same caption and is unofficially reported as P.R. Bar Ass'n. Adv. Sh. 1990-88; 90 JTS 99.

STATEMENT OF THE CASE

I. The Statutory Framework

The Municipality of Mayaguez is a political and juridical entity with full legislative and administrative powers in any matter of municipal nature. 21 L.P.R.A. 2051. As may be prescribed by the Legislature of the Commonwealth of Puerto Rico, a municipality may impose Income Taxes and License Fees for the purposes of the municipal government. Act of Congress of March 2, 1917 (Jones Act), c. 145, Section 3, 39 Stat. 953 and Act of Congress of April 12, 1900 (Foraker Act), c. 191, Section 38, 31 Stat. 86.

The Legislature of the Commonwealth of Puerto Rico enacted in 1974 the present Municipal License Tax Act, 21 L.P.R.A. Secs. 651-652y, which authorizes all municipalities to collect municipal license taxes from every person engaged for profit in the rendering of any service, in the sale of goods, in any financial business or in any industry or business in the municipalities of the Commonwealth of Puerto Rico. 21 L.P.R.A. 651c.

The Municipal License Tax Act imposes its revenue tax on a commercial bank's "volume of business" which is defined as:

> "(B) Financial business. – Where financial business is involved, the volume of business shall be the gross income received or earned, excluding:
>
> > "(1) reimbursement of advances, loans and credits granted, but the sum deducted on this account shall not exceed the principal of said advances, loans or credits;
> >
> > "(2) the deposits; and

> "(3) losses incurred in any operation in securities, but the deduction made on that account shall not exceed the total amount of the profits obtained for said securities.
>
> "In the specific case of commercial banks and savings and loan associations, mutual or savings banks, the gross income shall mean the interest received or earned on loans, the fees for services rendered, the rents, the gross benefit in the sale of property or securities and the profits, benefits and income derived from any other source.
>
> "The gross income earned by these organizations subject to payment of licenses shall be distributed among the branches in accordance with the proportion of all kinds of deposits of the branch with the total deposits of the organization." 21 L.P.R.A. 651a(a)(6)(B).[1]

On August 24, 1984, the Secretary of the Treasury of the Commonwealth of Puerto Rico, under the authority granted to him by the Municipal License Tax Act prescribed and filed Regulation No. 3142, the "Municipal License Tax Regulation" (hereinafter referred to as "Regulation No. 3142").

To the definition of a Bank's Volume of Business provided in Section 651a(a)(6)(B) (cited above), Article 2(7)(B) of Regulation No. 3142 adds the words we have italicized below as quoted from this Article:

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[1] The municipalities in Puerto Rico have been authorized by the Puerto Rico Legislature to impose Municipal License Taxes since 1914. The apportionment rules herein established for banks was an amendment to the present 1974 Act.

"Banks –

"In the specific case of commercial banks and savings and loan associations, mutual or savings banks, the gross income shall mean the interest received or earned on loans, the fees for services rendered, the rents, the gross benefit in the sale of property or securities and the profits, benefits and income derived from any other source *within or outside of Puerto Rico, attributable to the operation in Puerto Rico. Provided, however, interest on the obligations of the Commonwealth of Puerto Rico, its instrumentalities and municipalities as well as the obligations of the United States shall not be included as gross income.*

"The gross income derived by all financial organizations subject to the payment of the municipal license tax shall be distributed among the individual branches based on the deposits of such branches as a proportion of the total deposits of the organization."

II. Framework of the Dispute

Respondent Banco Popular de Puerto Rico is a Bank organized under the Laws of the Commonwealth of Puerto Rico and has its principal corporate office in San Juan, Puerto Rico. In addition to the banking branches it has established in almost all the municipalities in our Island, Banco Popular de Puerto Rico has branches in California, New York and the U.S. Virgin Islands.

In 1980 the Municipality of Mayaguez issued a Notice of Deficiency for the payment of Municipal License Tax as provided by 21 L.P.R.A., Section 651o of the Municipal License Tax Act. Respondent alleged that Petitioner had

excluded from its volume of business computations in its municipal license tax returns the following items:

(a) Income derived from Investments outside Puerto Rico.[2]

Interest due from foreign banks time	$120,568,129
Securities discount accretion of foreign securities	1,333,439
Interest foreign securities under resale	1,883,590
Interest of foreign banks acceptances	206,628
Interest other foreign securities or investments	29,066,000
	$153,057,786

b) Gross Income derived from bank branches outside Puerto Rico.

California, St. Croix and New York branches income	$15,950,283

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[2] These numbers, as obtained from the Puerto Rico Franchise Tax Return, were stipulated in the Trial Court and pertain to only one tax year (1982) of the controversy. The reference to foreign banks includes U.S. Banks.

(c) Interest Income from obligations of the U.S. Federal and Puerto Rico Government and their Instrumentalities and Municipalities[3]

$62,776,703

In the Per Curiams, the Supreme Court sustained the tax deficiency imposed by the Municipality and clearly stated that the computation of volume of business is based on the following formula:

Deposits of the Bank in the Municipality of Mayaguez	X	Gross Income	=	Volume of Business
Total deposits of the Bank		from all sources		subject to Municipal Tax in Mayaguez

In the second opinion, the Supreme Court of Puerto Rico ratified the interpretation contained in the first Per Curiam opinion and ordered the computation of any excess tax credits which could have been paid to any jurisdiction outside of Puerto Rico. This second opinion reaffirmed the above stated formula with no other possible interpretation.

[3] Both the Trial Court and the Commonwealth of Puerto Rico Supreme Court held that this income was free from municipal license taxation. This ruling is not at issue herein.

REASONS FOR DENYING THE PETITION

As Regards the First Question Presented in the Petition:

I. THE COURT NEED NOT REVIEW THIS QUESTION BECAUSE THE SUPREME COURT OF THE COMMONWEALTH OF PUERTO RICO'S DECISION IS NOT IN DIRECT CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT.

The decision of the Puerto Rico Supreme Court is not in direct conflict with applicable decisions of this court and the Petitioner has not demonstrated the contrary.

Petitioner's contention is based on the allegation that the Municipal License Tax as imposed on Petitioner violates the four-pronged test for determining the validity of a state tax under the Commerce Clause as applied in the decision of *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274 (1977). Specifically, Petitioner alleges that the tax is not internally consistent. This test requires that "to be internally consistent, the tax must be structured so that if every state were to impose an identical tax, no multiple taxation would result."

In its request for a writ of certiorari, Petitioner, who has the burden of proof, fails to substantiate its position. The Petitioner's first question presented for review is, essentially, based upon the following three allegations:

(a) Petitioner alleges that the Municipal License Tax Act and the Per Curiam opinions of the Supreme Court of Puerto Rico are not clear because they lack guidelines

and definitions in relation to foreign source income.

Contrary to this allegation, the guidelines are very clear. We have outlined in the statement of facts the formula of the last paragraph of 21 L.P.R.A. 651 a (a)(6)(B) which specifically governs the apportionment of a bank's income. The Puerto Rico Supreme Court reaffirmed that the income from all sources within and without Puerto Rico is includable in the computation.[4] The formula is a clear guideline that simply requires a mathematical computation of including all income and apportioning it according to the deposits in each branch.

As a basis for the lack of guidelines in the Municipal License Tax Act, Petitioner cites *Sea-Land Services, Inc v. Municipality of San Juan*, 505 F Supp 523 (1980). This case is totally immaterial to the present circumstances since there is clearly no apportionment guideline in the Municipal License Tax Act for the shipping industry whereas there is one for the banking industry.

(b) Petitioner alleges that even if the apportionment formula of the last paragraph of 21 L.P.R.A. 651a(a)(6)(B) were to be construed as interpreted by the Supreme Court of Puerto Rico, it would still present the question as to whether the tax was fairly apportioned.

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[4] Up to the year 1962 the prior Municipal License Tax Acts required that the Volume of Business income subject to the tax be from the operations conducted in Puerto Rico. The limitation of Puerto Rico source income was deleted by legislation.

The only argument used by Petitioner to sustain this allegation is that each municipality in the Commonwealth of Puerto Rico could interpret the "attributable" income in a different light as to create confusion and inconsistent application of the apportionment formula. We assume that the Petitioner's contention is that this would subject the bank to multiple taxation in violation of the Commerce clause. We disagree. The Puerto Rico Supreme Court avoided the issue of defining what is attributable, because it was not necessary. The formula distributes the income among all the branches within and without Puerto Rico and the income, as computed, is attributed to the respective municipalities. In *Trinova Corporation v. Michigan Department of Treasury* , 498 U.S. ___, 112 L. Ed. 2d 884, 904, 111 S. Ct. ___ (1991) this court affirmed "We seek to avoid formalism and to rely upon a 'consistent and rational method of inquiry [focusing on] the practical effect of a challenged tax.' *Mobile Oil Corp. v. Commissioner of Taxes of Vt.* 445 US 425, 443, 63 L Ed 2d 510, 100 S Ct 1223 (1980)."

The Petitioner, in effect, raises the issue of fairness providing no proof of the unreasonableness of the apportionment formula as applied to the bank. To prove internal inconsistency the obvious component of unfairness has to be proven. Also, in the petition, there is not one allegation on how the Petitioner could be subject to multiple taxation in other states.

In fact, the apportionment formula is not specifically contested as being unfair. Banco Popular de Puerto Rico is a corporation organized under the provisions of the Banking Law of the Commonwealth of Puerto Rico, 7 L.P.R.A. 1 et seq., and duly registered as a domestic

corporation under the provisions of the General Corporation Law of the Commonwealth of Puerto Rico, 14 L.P.R.A. 1 et seq. Its principal offices and central management are in San Juan, Puerto Rico. The direction of all active and passive investment is located in San Juan. The bank is one unit engaged in the same business. The principal matter in this case concerns the foregoing source of passive income obtained from the investment of the excess funds of all the branches of the bank. These excess funds are managed by the principal office and the income generated is not limited to a specific branch.

The legislature of the Commonwealth of Puerto Rico provided an apportionment formula as a necessary element of fairness in taxation. The tax is not geared to allocating all of the bank's out-of-state income to Puerto Rico or to a particular municipality. Instead, it is structured in the context of dividing the tax base by apportionment. If no formula had been enacted, each branch would have only the income from the services it provided. The excess passive income would all be received by the principal office in San Juan in detriment of the local and exterior branches that generated the deposits. The formula was devised and is premised on fair and equitable grounds because it directs distribution of all income among all the branches.

This Court has consistently ruled that the Constitution imposes no single formula on states imposing a tax. The apportionment measure of the *Complete Auto Transit, Inc. v. Brady* case cited by Petitioner is but one of the formulas utilized by this Court. See e.g. *Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978). The critical point which has been complied with by our statute is that

the gross receipt tax levied upon the interstate activity reflects the portion of the bank's activity that is conducted within the Commonwealth of Puerto Rico.

(c) Petitioner alleges that the Supreme Court of Puerto Rico conceded for all practical purposes that the Municipal License Tax Act was unconstitutional as it pertains to non Puerto Rico source income of the bank and attempted to save the statute by fashioning a "remedy" for the tax.

The apportionment formula of our Municipal License Act is fair and does not require a tax credit provision for it to be constitutional. In any event our Supreme Court did interpret that such credit for taxes paid is available in our Municipal License Tax Law. This leads to the second issue presented for review.

As Regards the Second Question Presented In The Petition:

II. RATHER THAN A CONTRIVANCE TO DEFEAT REVIEW BY THIS COURT, THE PUERTO RICO SUPREME COURT'S RECOGNITION OF THE CREDIT IS A VALID EXERCISE OF JUDICIAL INTERPRETATION.

As a second issue presented for review, the Petitioner asserts that the decision of the Supreme Court of Puerto Rico does not rest on adequate and independent state ground, essentially on the allegation that the Puerto Rico Supreme Court's recognition of a credit against the municipal license tax is "merely a contrivance to try to defeat this court's review of the validity of the tax at

issue." The Petitioner's allegation is totally unreasonable and without substance.

Rather than a contrivance or device to defeat this Court's jurisdiction, the Puerto Rico Supreme Court's decision represents a valid exercise of judicial interpretation to secure, as the Court itself affirms, the constitutionality of the Municipal License Tax Act. Petitioner does not assert in its argument of the second issue presented for review that there exists a constitutional problem with the credit itself, upon a recognition of the credit by the Puerto Rico Supreme Court. The Petitioner merely limits himself to argue, in unreasonable terms, that the Puerto Rico Supreme Court's reading of the statute is a contrivance or device to defeat this Court's jurisdiction.

As well as failing to present a plausible argument that the Puerto Rico Supreme Court's recognition of the credit via judicial interpretation is an unreasonable interpretation of the law, the Petitioner fails to allege facts, judicial precedent or any court opinion that would indicate the recognition of this credit is not a proper exercise of the Puerto Rico Supreme Court's interpretive faculty in reviewing a state law, or that a constitutional transgression or deprivation has been committed by the Puerto Rico Supreme Court's interpretation of the law. The only fact that the Petitioner presents to establish its contention is that the statute does not specifically define "excess payments" as payments made to other states pursuant to such other states' laws. However, it cannot be denied that there is a statutory basis for the Puerto Rico Supreme Court's interpretation: 21 L.P.R.A. 652f(a)(1).

The Puerto Rico Supreme Court, in all practical terms, has developed meaning to the text of the law in the face of new and changing circumstances. The meaning given to the text of the law by the Puerto Rico Supreme Court should be authoritative, particularly considering the absence of any persuasive argument by the Petitioner that there is a widely shared, restrictive, definition of "excess payments" that excludes any other meaning.

Clearly, the Petitioner does not present sufficient facts or any court decisions to warrant review of the Puerto Rico Supreme Court's decision recognizing the credit; a recognition that was accomplished in order to achieve an interpretation which is congruent and compatible with the maintenance of the constitutionality of a law, all of which is in conformance with the judicial discretion that the Puerto Rico Supreme Court has exercised in prior cases[5] and which reflects sound judicial principle. In *Hooper v. California*, 155 U.S. 648, 657 (1895), the Supreme Court of the United States indicated "the elementary rule is that every reasonable construction must be resorted to in order to save a statute from unconstitutionality." In *Rust v. Sullivan*, 500 U.S. ___, 114 L. Ed. 2d 233, 253-254, 111 S. Ct. ___ (1991), this Court affirmed the above principle: "The principle enunciated in *Hooper vs. California*, supra, and subsequent cases is a categorical

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[5] See the Puerto Rico Supreme Court's opinion of *Banco Popular de Puerto Rico v. Municipality of Mayaguez*, P.R. Bar Ass'n. Adv. Sh. 1990-88; 90 JTS 99, mentioning cases of *P.R.P. v. C.W.P.R.*, 115 D.P.R. 631, 642 (1984); *Milan Rodríguez v. Muñoz*, 110 D.P.R. 610, 618 (1981).

one: 'as between two possible interpretations of a statute, by one of which it would be unconstitutional and by the other valid, our plain duty is to adopt that which will save the Act.' *Blodgett vs. Holden*, 275 US 142, 148, 276 US 594, 72 L ED 206, 48 S CT 105 (1927) (opinion of Holmes, J.)."

As Regards The Third Question Presented In The Petition:

III. THE ALLEGATION THAT MATTERS OF NATIONAL CONCERN ARE RAISED IS AN INANE, UNSUBSTANTIATED CONTENTION THAT MUST BE ASSESSED IN LIGHT OF THE PETITIONER'S FAILURE TO SUBSTANTIATE ANY EROSION OF CONSTITUTIONAL PRINCIPLES OR THAT THE PUERTO RICO SUPREME COURT'S DECISION IS IN CONFLICT WITH THE DECISIONS OF THIS COURT.

The Petitioner pretends to convince this Court that review of the Puerto Rico Supreme Court decision is warranted, under the pretext that matters of national concern are presented in a new factual context. However, the contention that matters of national concern are raised must be assessed in light of the Petitioner's failure to substantiate any erosion of constitutional principles enunciated by this Court or that the Puerto Rico Supreme Court has not followed the authoritative pronouncements of this Court.

The Puerto Rico Supreme Court adjudicated the controversies presented before it based upon sound judicial doctrine. The Petitioner's allegations do not sustain the argument that the Puerto Rico Supreme Court's decision

has departed from, or is in conflict with any of this Court's decisions. The temptation of granting a writ based upon an inane, unsubstantiated contention that matters of national concern are raised should be balanced against these factors. In addition, in the absence of a clear showing of a constitutional problem, there should exist the opportunity of state courts, in this case the Puerto Rico Supreme Court, to develop meaning to the principles enunciated by this Court without the need of continued review whenever a different contextual situation is presented. We therefore respectfully submit that judicial repose, instead of judicial scrutiny, is warranted and appropriate in this case.

CONCLUSION

For the reasons stated in this brief, the petition for writ of certiorari should be denied.

Respectfully submitted,

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